

IN THE COURT OF APPEALS OF TENNESSEE
AT KNOXVILLE
September 15, 2005 Session

**INTERNATIONAL PLAYING CARD AND
LABEL COMPANY, INCORPORATED v. LOREN L. CHUMLEY,
COMMISSIONER OF REVENUE, STATE OF TENNESSEE**

**Appeal from the Chancery Court for Hawkins County
No. 15480 Thomas R. Frierson, II, Chancellor**

No. E2005-00581-COA-R3-CV - FILED DECEMBER 5, 2005

After an audit, the State of Tennessee Department of Revenue (“the State”) assessed International Playing Card and Label Company, Incorporated (“IPC&L”) back sales and use taxes on two machines that IPC&L had purchased and now uses in its printing business. IPC&L contested the assessment and filed suit. After a non-jury trial, the Trial Court entered its Final Judgment finding and holding, *inter alia*, that the machines at issue are “exempt from the imposition of sales and use tax pursuant to the provisions of Tenn. Code Ann. § 67-6-102(a)(14)(A)(2003).” The State appeals claiming that the two machines at issue do not satisfy the requirements of Tenn. Code Ann. § 67-6-102(a)(14)(A), that they are used for maintenance, and that for these reasons they are not exempt from sales and use tax. We affirm.

**Tenn. R. App. P. 3 Appeal as of Right; Judgment of the Chancery Court Affirmed;
Case Remanded**

D. MICHAEL SWINEY, J., delivered the opinion of the court, in which HERSCHEL P. FRANKS, P.J., and SHARON G. LEE, J., joined.

Paul G. Summers, Attorney General and Reporter; and Jonathan N. Wike, Assistant Attorney General, for the Appellant, Loren L. Chumley, Commissioner of Revenue, State of Tennessee.

Robert L. Arrington and B. Andrew Glenn, Kingsport, Tennessee, for the Appellee, International Playing Card and Label Company, Incorporated.

OPINION

Background

IPC&L utilizes a process called gravure printing to print packaging materials or wrappers for tobacco, food, and other industrial clients. In addition to some other types of printing equipment, IPC&L uses two Schiavi brand printing presses. The two Renzmann Model 300-53 machines (“the Renzmann machines”) at issue in this case are designed to be used with the Schiavi printing presses.

IPC&L purchased the Renzmann machines in 2001 for approximately one million dollars. IPC&L did not pay sales and use tax on the machines at the time of purchase. The State performed an audit on IPC&L in late 2002 and early 2003 and concluded that IPC&L owed \$102,217 in back taxes for the Renzmann machines.¹ The audit report states:

The press washing system is not exempt for sales and use tax and does not qualify as industrial machinery. The washing equipment is freestanding and operates independently from the printing press. Its function is to clean and maintain parts of the printing press. During the printing process, parts of the press come into contact with various inks specific to the printing job. Before another printing job can be started, ink must be cleaned from the printing press so that the next printed material will not be corrupted by unwanted inks. Equipment used for maintenance is not exempt and is specifically excluded from the definition of industrial machinery as stated in Tenn. Code Ann. 67-6-102(13)(f).

IPC&L disagreed with the audit. Michael Griffin, IPC&L’s vice president in charge of finance and human resources, wrote a letter to the auditor stating:

It is our understanding that pre-press equipment is specifically exempt. For the purposes of this audit and future audits, our pre-press operation consists of 1) making engravings. These engravings are, in some cases, sold to the customers and in all cases, to make the product. 2) We mix inks and solvents for the production process. 3) Press parts and engravings have to be washed. On some presses, the washing takes place on the press. On others, such as ours, they are separate.

The State sent IPC&L a Notice of Assessment and IPC&L filed this lawsuit.

The case was tried without a jury in November of 2004. At trial, Terry Johnson, IPC&L’s plant manager, testified that “gravure printing is a process that is designed to be able to

¹The Notice of Assessment stated a total sales and use tax due of \$116,974.40. In this lawsuit, IPC&L contests only the portion attributable to the Renzmann machines.

reproduce colors - - logo colors. For instance, like Marlboro red, which our customers require to be very precisely color controlled, and gravure printing is the only printing that can do that over long runs.” Mr. Johnson testified that IPC&L’s customers sometimes spend millions to develop a color, and IPC&L cannot sell its product if the printing is off by even a shade.

Mr. Johnson explained that gravure printing uses “a printing cylinder which is etched or engraved ... plates are very durable, we can run millions of labels with high color consistency.” Mr. Johnson testified that the ink is in a tank that is part of the printing carriage or trolley. The cylinder turns and picks up the ink from the carriage and then imprints on to the paper or film. Mr Johnson described the pre-press operation and stated:

the first step is the actual clean-up of - - of all these parts which are incorporated in the trolley of any ink residue. The problem that we have in the gravure industry supplying our customers is that we have to remove every trace of the previous ink from the previous job in order not to contaminate the colors for the next job. Specifically because we use a lot of metallic inks which are very difficult to remove. We have to clean all those metallic particles out of the trolley and out of the inking system which is part of the trolley in order to be able to maintain the color for the next job.

After the cleaning, the equipment is reassembled to put the new cylinder into the trolley and ink is applied to begin printing the job. Mr. Johnson testified that without the Renzmanns “we could not successfully produce our product” because they would not be able to maintain color consistency over a run. Mr. Johnson testified that the first Schiavi press that IPC&L acquired came with an integrated washing system, but this attached system “did not function to the extent that we needed ...,” so IPC&L purchased the Renzmann machines. Mr. Johnson testified that approximately three times a week, they have to interrupt or “break into the job” to do a rush order and then resume the first job. When this happens, it is necessary to thoroughly wash the press parts to prevent corrupting the ink colors. Mr. Johnson testified that it is not possible to wash the Schiavi parts manually or by hand because to do so would violate OSHA statutes.

The Renzmann machines are operated by the press assistants who are classified as operators. They are production people, not maintenance personnel. Mr. Griffin, who has been the vice president in charge of finance and human resources at IPC&L for 14 years and has worked in the printing industry for 21 years, testified:

the press assistants basically do four things. They are the assistants on the press, and then they also do all three of these pre-press functions, they mix the inks, they mount the cylinders, they wash the parts, as well as operate the press with the overall press operator as sort of a team leader.

Mr. Griffin testified that the operator’s time spent to pull the carriage out of the Schiavi press to take it to the Renzmann machines is charged to the next job rather than to the job that was just printed.

Mr. Griffin testified that maintenance employees are not permitted to operate the Renzmann machines and stated: “we would have a lot of grievances from our union if they did because it’s considered a production piece of equipment.”

The Renzmann machines are kept in a separate room from the Schiavi presses due to EPA regulations. The Renzmann machines use hazardous chemicals and IPC&L must keep the room that houses them at negative pressure, evacuate the fumes, and burn those fumes per EPA regulations.

Both Mr. Griffin and Mr. Johnson testified that the Renzmann machines fit into the pre-press or make-ready process. Mr. Johnson stated: “As part of my experience of over 20 years in the business, I’ve been in probably better than half of the gravure operations in this country. And I think anyone that you would speak to in my position at those companies would say that they are pre-press.” Mr. Johnson further testified that the Renzmann machines are a part of the printing process and stated: “If those machines go down, our production quits.” Mr. Johnson testified that if the Renzmann machines became inoperable, IPC&L would be able to complete the job that currently was on the press, but then production would halt. Mr. Johnson and Mr. Griffin also testified that customers are specifically charged for the use of the Renzmann machines because every quotation includes a make-ready or pre-press charge. Mr. Johnson testified that the same solvents used in the washing process on the Renzmann machines are used to make the inks. These solvents are not detergents. Mr. Johnson testified that the Renzmann machines are used in the manufacturing of IPC&L’s product and that the purpose of using the Renzmann machines is to prepare for the next job. Mr. Griffin testified that the Renzmann machines were sold to IPC&L as “part of our pre-press operation ... it’s just a given in the industry that this is one of the functions that constitutes pre-press.” Mr. Griffin further testified that he has attended trade shows and seen Renzmann machines on display in the pre-press area.

Mr. Griffin testified that he disagrees with the State’s audit report for several reasons. Mr. Griffin’s position is that the fact that the Renzmann machines are freestanding should not be relevant to the analysis. He further testified that he disagrees with the audit because the Renzmann machines are not pieces of maintenance equipment. Mr. Griffin testified that in the past, IPC&L had purchased other parts washers that were not as large or as expensive as the Renzmann machines and IPC&L did not pay any tax on those machines when purchased and no back tax was assessed on those machines when IPC&L was audited. Mr. Griffin testified that they did not pay tax on the Renzmanns when purchased because: “We assumed based upon our knowledge and experience that because it was part of the manufacturing process that it was exempt from sales tax.”

The Trial Court entered its Final Judgment February 14, 2005. The Final Judgment incorporated by reference the Trial Court’s Memorandum Opinion filed in January of 2005. In the Final Judgment, the Trial Court found and held, *inter alia*, that the Renzmann machines at issue are “exempt from the imposition of sales and use tax pursuant to the provisions of Tenn. Code Ann. § 67-6-102(a)(14)(A)(2003),” and that the assessment of sales and use tax in the amount of \$102,217 plus any accrued interest is “declared void and for nothing held” The Trial Court also awarded

IPC&L attorney's fees and costs pursuant to Tenn. Code Ann. § 67-1-1803. The Trial Court also found and held:

In the case at bar, the Renzmann washing system machines are used to clean the Schiavi gravure printing press parts and accessories in connection with every production job. Failure to completely and properly clean the printing cylinders and carriage assemblies will result in a failure of [IPC&L's] products to meet its customers' specifications. The evidence supports a determination that the Renzmann washing system machines are not used to maintain the printing cylinders and carriage assemblies. Instead, the cleaning system is an integral component of the production process. Accordingly, this Court concludes that the Renzmann washing system machines do not constitute maintenance equipment as defined by T.C.A. 67-6-102(a)(14)(F)(2003).

Regarding the issue of whether [IPC&L's] washing system machinery qualifies as "industrial machinery" as defined by T.C.A. 67-6-102(a)(14)(A)(2003), IPC&L relies upon the recent decision of the Tennessee Supreme Court in Eastman Chemical Company v. Johnson, 2004 LEXIS 994 (S.Ct. 2004) wherein the Court determined that certain chemical catalysts used by Eastman Chemical fell within the "industrial machinery" exemption. In its conclusion, the Supreme Court found that the catalysts were "an integral part of the totality of means whereby the manufacturing processes are accomplished." Applying this construction of the respective tax exemption statute to the action *sub judice*, this Court concludes that the Renzmann 300-53 washing system machines are an integral part of the totality of means whereby [IPC&L's] gravure label manufacturing processes are accomplished. This industrial machinery is necessary to and primarily for the processing of tangible personal property for resale off the premises. As such, the washing system machines qualify as "industrial machinery" pursuant to T.C.A. 67-6-102(a)(14)(A)(2003). Accordingly, [IPC&L] is entitled to the tax exemption at issue.

The State appeals to this Court.

Discussion

Although not stated exactly as such, the State raises two issues on appeal: 1) whether the Trial Court erred in holding that the Renzmann machines at issue were exempt from sales and use tax as industrial machinery pursuant to Tenn. Code Ann. § 67-6-102(a)(14)(A); and, 2) whether the Trial Court erred in holding that IPC&L is entitled to the tax exemption because the Renzmann machines at issue are not used merely for maintenance pursuant to Tenn. Code Ann. § 67-6-102(a)(14)(F). IPC&L raises a third issue which we state as: whether the Renzmann machines at issue also are exempt from sales and use tax because they constitute machinery used in pre-press and press operations pursuant to Tenn. Code Ann. § 67-6-102(a)(14)(C).

Our review is *de novo* upon the record, accompanied by a presumption of correctness of the findings of fact of the trial court, unless the preponderance of the evidence is otherwise. Tenn. R. App. P. 13(d); *Bogan v. Bogan*, 60 S.W.3d 721, 727 (Tenn. 2001). A trial court's conclusions of law are subject to a *de novo* review with no presumption of correctness. *S. Constructors, Inc. v. Loudon County Bd. of Educ.*, 58 S.W.3d 706, 710 (Tenn. 2001).

As pertinent to this appeal, Tenn. Code Ann. § 67-6-206 provides: “After June 30, 1983, no tax is due with respect to industrial machinery.” Tenn. Code Ann. § 67-6-206(a) (2003). Thus, if IPC&L can prove that the Renzmann machines fall into the definition of “industrial machinery” provided in Tenn. Code Ann. § 67-6-102, then IPC&L owes no sales and use tax on the Renzmann machines.

The issues presented in this appeal require that we construe and apply Tenn. Code Ann. § 67-6-102. As our Supreme Court has instructed:

Our duty in construing statutes is to ascertain and give effect to the intention and purpose of the legislature. *See Lipscomb v. Doe*, 32 S.W.3d 840, 844 (Tenn. 2000); *Freeman*, 27 S.W.2d at 911. “‘Legislative intent is to be ascertained whenever possible from the natural and ordinary meaning of the language used, without forced or subtle construction that would limit or extend the meaning of the language.’” *Lipscomb*, 32 S.W.3d at 844 (*quoting Hawks v. City of Westmoreland*, 960 S.W.2d 10, 16 (Tenn. 1997)).

* * *

In addition to general principles of statutory construction, we must also consider the rules of construction specifically applicable to tax statutes. Statutes imposing a tax are to be construed strictly against the taxing authority. *See Covington Pike Toyota, Inc. v. Cardwell*, 829 S.W.2d 132, 135 (Tenn. 1992). However, statutes granting exemptions from taxation are construed strictly against the taxpayer. *Tibbals Flooring Co. v. Huddleston*, 891 S.W.2d 196, 198 (Tenn. 1994); *Covington Pike Toyota*, 829 S.W.2d at 135.

Eastman Chem. Co. v. Johnson, 151 S.W.3d 503, 506-07 (Tenn. 2004).

We first will address whether the Trial Court erred in holding that the Renzmann machines at issue were exempt from sales and use tax as industrial machinery pursuant to Tenn. Code Ann. § 67-6-102(a)(14)(A). In pertinent part, Tenn. Code Ann. § 67-6-102(a)(14)(A) states:

(14) “Industrial machinery” means:

(A) Machinery, apparatus and equipment with all associated parts, appurtenances and accessories, including hydraulic fluids, lubricating oils, and

greases necessary for operation and maintenance, repair parts and any necessary repair or taxable installation labor therefor, which is necessary to, and primarily for, the fabrication or processing of tangible personal property for resale and consumption off the premises, or pollution control facilities primarily used for air pollution control or water pollution control, where the use of such machinery, equipment or facilities is by one who engages in such fabrication or processing as one's principal business
....

Tenn. Code Ann. § 67-6-102(a)(14)(A) (2003).

IPC&L relies upon *Eastman Chem. Co. v. Johnson*, wherein our Supreme Court held that the catalysts at issue in that case fell within the definition of industrial machinery “because they are integral parts of the equipment and apparatus used by [the plaintiff].” *Eastman Chem. Co.*, 151 S.W.3d at 510. The Trial Court in the instant case found and held, *inter alia*,

that the Renzmann 300-53 washing system machines are an integral part of the totality of means whereby [IPC&L's] gravure label manufacturing processes are accomplished. This industrial machinery is necessary to and primarily for the processing of tangible personal property for resale off the premises. As such, the washing system machines qualify as “industrial machinery” pursuant to T.C.A. 67-6-102(a)(14)(A)(2003).

The evidence shows that the Renzmann machines are designed to be used with the Schiavi printing presses and that the Renzmann machines replaced another washing system that was attached to the printing press. The evidence further shows that it is critical for IPC&L to be able to reproduce very specific colors and to maintain color consistency throughout the print run. Failure to reproduce colors throughout the print run would result in IPC&L being unable to sell the finished product. The evidence shows that the Renzmann machines are an integral part of the process of reproducing specific colors without contamination. The evidence also shows that IPC&L utilizes metallic inks which are very difficult to remove and that without the Renzmann machines, IPC&L would not be able to produce its products successfully. The evidence shows that the integrated washing system that came with the Schiavi press simply did not function well enough for IPC&L to produce its products.

The evidence shows, as found by the Trial Court, that the Renzmann machines are appurtenances or accessories necessary for the operation of the Schiavi presses and are necessary to, and primarily for, the fabrication or processing of tangible personal property for resale and consumption off of IPC&L's premises. “When a trial court has seen and heard witnesses, especially where issues of credibility and weight of oral testimony are involved, considerable deference must be accorded to the trial court's factual findings.” *Seals v. England/Corsair Upholstery Mfg. Co.*, 984 S.W.2d 912, 915 (Tenn. 1999) (quoting *Collins v. Howmet Corp.*, 970 S.W.2d 941, 943 (Tenn.1998)). The evidence does not preponderate against the Trial Court's findings, and we agree with the Trial Court's findings and holding that the Renzmann machines:

are an integral part of the totality of means whereby [IPC&L's] gravure label manufacturing processes are accomplished. This industrial machinery is necessary to and primarily for the processing of tangible personal property for resale off the premises. As such, the washing system machines qualify as "industrial machinery" pursuant to T.C.A. 67-6-102(a)(14)(A)(2003).

We affirm on this issue.

We next address whether the Trial Court erred in holding that IPC&L is entitled to the tax exemption because the Renzmann machines are industrial machinery not used merely for maintenance pursuant to Tenn. Code Ann. § 67-6-102(a)(14)(F). Tennessee Code Annotated § 67-6-102(a)(14)(F) provides:

(F) Such industrial machinery necessary to and primarily for the fabrication or processing of tangible personal property for resale and consumption off the premises or used primarily for the control of air pollution or water pollution does not include machinery, apparatus and equipment used prior to or after equipment exempted by subdivision (a)(14)(D)(ii), and does not include equipment used for maintenance or the convenience or comfort of workers;

Tenn. Code Ann. § 67-6-102(a)(14)(F) (2003). In pertinent part, Tenn. Code Ann. § 67-6-102(a)(14)(D)(ii) provides:

(D) Such industrial machinery necessary to and primarily for the fabrication and processing of tangible personal property for resale or used primarily for the control of air pollution or water pollution includes, but is not limited to:

* * *

(ii) Equipment used in transporting raw materials from storage to the manufacturing process, and transporting finished goods from the end of the manufacturing process to storage;

Tenn. Code Ann. § 67-6-102(a)(14)(D)(ii) (2003).

The State urges this Court to follow the reasoning in *Norandal USA, Inc. v. Johnson*, when deciding this issue. However, our Supreme Court denied the Rule 11 application for certiorari in that case and specifically designated the *Norandal USA, Inc.* Opinion of this Court "**Not for Citation**" in accordance with Supreme Court Rule 4, § F." *Norandal USA, Inc. v. Johnson*, M2003-0059-SC-R11-CV, 2005 Tenn. LEXIS 23 (Tenn. Jan. 18, 2005). Therefore, we will not consider *Norandal USA, Inc.*

The State also argues, in part, that the Renzmann machines are used at the end of each printing job “after the equipment (the printing press) used to fabricate or process has completed its portion of the fabrication or processing.” The State argues that the Renzmann machines are used after “transporting finished goods from the end of the manufacturing process to storage.” Tenn. Code Ann. § 67-6-102(a)(14)(D)(ii) (2003).

The evidence, however, does not support the State’s argument. Instead, the evidence shows that the Renzmann machines are used at the beginning of each print job, not at the end after the finished materials are transported to storage. Both Mr. Johnson and Mr. Griffin testified that the Renzmann machines are used at the beginning of each job and the evidence shows that the operator’s time spent to take the press parts to the Renzmann machines is charged to the next job and not to the job just completed. In addition, the evidence shows that customers are billed for the use of the Renzmann machines as a pre-press charge, which supports a finding that the Renzmann machines are used at the beginning of each job and not at the end after the finished goods are transported to storage.

As to whether the Renzmann machines are used merely for maintenance, the Trial Court found and held:

In the case at bar, the Renzmann washing system machines are used to clean the Schiavi gravure printing press parts and accessories in connection with every production job. Failure to completely and properly clean the printing cylinders and carriage assemblies will result in a failure of [IPC&L’s] products to meet its customers’ specifications. The evidence support a determination that the Renzmann washing system machines are not used to maintain the printing cylinders and carriage assemblies. Instead, the cleaning system is an integral component of the production process. Accordingly, this Court concludes that the Renzmann washing system machines do not constitute maintenance equipment as defined by T.C.A. 67-6-102(a)(14)(F)(2003).

We agree. The evidence shows that the Renzmann machines are used at the beginning of every job to thoroughly clean the press parts to insure correct color and color consistency throughout the print run. The evidence supports a determination that the Renzmann machines are used in the production process and not simply to maintain the printing press parts. The evidence shows that without the Renzmann machines, IPC&L would not be able to produce its products successfully. The evidence further shows that if the Renzmann machines stopped working, IPC&L would be able to finish the job then on the press, but production on the next scheduled job could not proceed. The evidence shows that a charge for the use of the Renzmann machines is billed to each customer, which also supports a determination that the Renzmann machines are used for production and not mere maintenance. The evidence further shows that the Renzmann machines are operated solely by production personnel, not maintenance personnel, and that the operator’s time spent to take the press parts to the Renzmann machines is charged to the next job and not to the job just completed. In addition, Mr. Johnson testified that the same solvents used in the washing process on the Renzmann

machines are used to make the inks and that these solvents are not detergents. Clearly the evidence does not preponderate against the Trial Court's finding that the Renzmann machines are not used merely for maintenance but instead are "an integral component of the production process." We affirm on this issue.

Finally, we address whether the Renzmann machines at issue also are exempt from sales and use tax because they constitute machinery used in pre-press and press operations pursuant to Tenn. Code Ann. § 67-6-102(a)(14)(A). The Trial Court did not specifically address this issue in its Memorandum Opinion finding instead that its determination of the two previously discussed issues pretermitted the necessity of addressing this argument. While we agree with the Trial Court's holdings and have affirmed on the two issues discussed above, we find also that IPC&L has a strong argument that it is entitled to an exemption because the Renzmann machines constitute industrial machinery used in the pre-press and press operations pursuant to Tenn. Code Ann. § 67-6-102(a)(14)(C).

In pertinent part, Tenn. Code Ann. § 67-6-102(a)(14)(C) provides:

(14) "Industrial machinery" means:

* * *

(C) Machinery utilized in the pre-press and press operations in the business of printing, including plates and cylinders, and including the component parts and fluids or chemicals necessary for the specific mechanical or chemical actions or operations of such machinery, plates and cylinders, regardless of whether or not the operations occur at the point of retail sales;

Tenn. Code Ann. § 67-6-102(a)(14)(C) (2003).

The State argues, in part, that since only plates and cylinders, and not washing equipment, is listed in the statute, this implies that our Legislature intended to exempt only those machines that actually contain a plate or cylinder, such as a printing press and since the Renzmann machines do not actually print, they cannot fall into the exemption provided by Tenn. Code Ann. § 67-6-102(a)(14)(C).

We disagree. The statute also states: "including the component parts and fluids or chemicals necessary for the specific mechanical or chemical actions or operations of such machinery" Tenn. Code Ann. § 67-6-102(a)(14)(C) (2003). The evidence shows, as found by the Trial Court, that the Renzmann machines are necessary for the specific operations of machinery used in the pre-press and press operations in IPC&L's printing business.

The evidence shows that the Renzmann machines are operated by the press assistants to prepare the press at the beginning of each job. The evidence shows that the Renzmann machines

are necessary to prepare the presses in order to achieve and maintain the correct color during printing. The evidence also shows that the operator's time spent to take the press parts to the Renzmann machines is charged to the next job and not to the job that has just been completed. The evidence shows that customers are billed for the use of the Renzmann machines as a pre-press charge. Mr. Johnson testified that the Renzmann machines are a part of the printing process and stated: "If those machines go down, our production quits." He further testified that if the Renzmann machines became inoperable, IPC&L would be able to complete the job that was on the press, but production then would halt.

The Trial Court saw and heard the witnesses and determined what weight to assign to the testimony, and, therefore, this Court affords the Trial Court's factual findings great deference. Although the Trial Court did not specifically address this issue, it did find that the "cleaning system is an integral component of the production process." The evidence does not preponderate against this finding. After a thorough review of the record on appeal, we hold that the Renzmann machines at issue also are exempt from sales and use tax because they constitute machinery used in pre-press and press operations pursuant to Tenn. Code Ann. § 67-6-102(a)(14)(C).

Conclusion

The judgment of the Trial Court is affirmed, and this cause is remanded to the Trial Court for collection of the costs below. The costs on appeal are assessed against the Appellant, Loren L. Chumley, Commissioner of Revenue, State of Tennessee.

D. MICHAEL SWINEY, JUDGE